

PENSION RESERVES INVESTMENT MANAGEMENT BOARD

To: All PRIM Investing Retirement Systems

From: Paul Todisco, Senior Client Service Officer

Date: November 14, 2008

Subject: How PRIM is responding to the current state of the financial markets

In light of the recent turmoil in the global financial markets, I wanted to explain what PRIM *is* and *is not* doing during these uncertain and volatile times. As we are all too painfully aware, the current crisis has affected both the U.S and foreign economies and has placed them on the precipice of a global recession. Because the market declines have affected everyone from Wall Street to Main Street, and extreme market movements have occupied the headlines on an almost a daily basis over the past 10 weeks or so, we believe it's important to remind our investing systems about PRIM's investment policies and procedures in an effort to respond to, or in some instances, anticipate questions from your beneficiaries or local officials.

First, PRIM continues to do what it has always done during difficult markets – remain a disciplined investor by adhering to the tenets of its written Investment Policy Statement and not try to time the market. During periods like this, it is imperative to keep the discipline of an established investment program. While this has become increasingly difficult with the magnitude of market losses, we believe that staying with our long term strategy is the most prudent and practical way to increase the probability of meeting PRIM's, and your, long term investment objectives. It would be a complete abrogation of PRIM's fiduciary duty to abandon its focus and sell out of poorly performing investments at any cost, and flee to asset classes perceived as relatively safe in this kind of environment. But that does not mean PRIM is playing a passive role as events unfold. PRIM staff closely monitors daily movements in the global markets, analyzes the strategies employed within each asset class, and conducts aggressive due diligence on its managers, ensuring that they are in compliance with their portfolio mandates and guidelines.

What PRIM is also doing during this turbulent period is rebalancing the PRIM Fund back to its target allocations by taking money from the better performing asset classes and putting it right back into the under-performing portfolios. This is in keeping with PRIM's written policies and it has worked to PRIM's benefit over its 24-year history. For example, in the months following the tech stock crash in the early part of this decade, PRIM took assets from its core fixed income portfolio, which was over-allocated due to steep declines in the equity markets, and funded its domestic, international equity, and

emerging markets equity managers. This decision was not made to time the market, in fact there were further declines before things turned around, but when the global equity markets did rebound in late 2002 and through 2003, PRIM was rewarded accordingly. Over the five-year period ending December 31, 2007, PRIT's domestic equity, international equity, and emerging markets portfolios saw gains of 13.83%, 21.67%, and 36.99%, respectively.

Let us not forget that most Massachusetts Retirement Systems have significant unfunded pension liabilities and we must allocate and diversify our assets in a way that can realistically achieve the rate of return assumptions contained in our funding schedules. In order to achieve the 8.25% return mandated by statute in the Commonwealth's pension funding schedule, PRIM must have some exposure to higher performing asset classes, such as publicly traded equities and private equity (buyouts and venture capital); however, we mitigate risk by diversifying into fixed income and other alternative investments such as real estate and hedge funds. This diversification has been the key to PRIM's success over its 24-year history.

Simply put, diversification has not worked this year and the asset classes that helped boost the PRIT Fund to an 80% cumulative return from 2003 to 2007 are mostly responsible for the Fund's current decline, but such is the cyclical nature of the market. Although the PRIT Fund has had an average annual return of more than 10% since inception, there have been years when PRIM has fallen short of that objective. And this year, PRIM will likely experience its worst ever annual return.

We also realize that retirement systems that joined PRIM either voluntarily or were mandated to under the provisions of Chapter 68 of the Acts of 2007 have not had a positive experience thus far in terms of investment performance. There are some systems that may have performed better than PRIM this year because of higher allocations to fixed income and underweighting to global equities. There are also those that would have been worse off. To those new systems, we remind you that the benefits and advantages of participating in the PRIT Fund will be realized in the long term, and we ask for your patience. We also stand ready to assist you in any way if you are being questioned by your mayors, selectmen, county advisory boards, finance committees, etc., and will attend any meetings with these officials upon your request.

In conclusion, PRIM believes it is well-positioned to withstand the volatility of this current market environment because of its disciplined investment approach and its broadly diversified portfolio. Through our ongoing client meetings, monthly performance letters, and our quick response to client and consultant inquiries, we are working as diligently as we can to keep your Retirement Board apprised of market events and assist you in focusing on long-term goals. While it is difficult and frustrating to absorb the market losses that are occurring, and while no one knows how long this volatility will last, we continue to believe that long term investors are rewarded for not reacting to shorter term dislocations, no matter how severe.